

Part II - Judicial Doctrines Used to Combat Abusive Tax Shelters

II.A. Introduction

Introduction

The IRS has two primary means to deny the tax benefits of tax shelters.

First, the IRS may argue that the objective facts of the transaction are not as the taxpayer has presented them. That is, the formal way in which the taxpayer has presented the facts belies their real substance and, as a result, the taxpayer is applying the wrong set of mechanical rules in reaching its purported tax consequences.

Second, the IRS may argue that while the facts are as the taxpayer has represented, the technical tax results produced by a literal application of the law to those facts are unreasonable and unwarranted, and therefore should not be respected. This second line of argument which encompasses long standing principles of business purpose and economic substance, is an important and essential gloss on our generally mechanical system of determining tax liabilities. Application of these doctrines to a particular set of facts is often uncertain. Typically, in the cases in which the IRS has been successful, the IRS has argued that the taxpayer's transaction was in some sense artificial, that the taxpayer undertook the transaction in a particular way (even though economically equivalent avenues were available to the taxpayer) to achieve an unreasonable or unwarranted tax benefit. Often, it is clear that if tax savings had not been an issue, the taxpayer would have used a more straight-forward (and more heavily-taxed) route.

**Joint
Committee on
Taxation**

The Joint Committee on Taxation (JCT) prepared a study on corporate tax shelters in 1999 that provides an excellent overview of the judicial doctrines used to combat abusive tax shelters. These doctrines are key components in most tax shelters.

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II.A. Introduction, Continued

**Judicial
Doctrines**

The judicial doctrines which the courts have created, developed and re-interpreted to address unreasonable or unwarranted tax benefits include:

- substance-over-form,
- step transaction doctrine,
- economic substance,
- sham transaction, and
- business purpose.

The JCT's Study on tax shelters, [JCX-84-99](#), will be used to discuss these doctrines in the next section, and the cases these doctrines are based on will be discussed in the second section.¹

¹ Joint Committee on Taxation, Description and Analysis of Present-Law Tax Rules and Recent Proposals Relating to Corporate Tax Shelters (JCX-84-99), November 10, 1999.